Summary of Public Meeting on Wyoming RIK Pilot
Casper, Wyoming February 24, 1998

Bonn Macy, Special Assistant to the Director, Minerals Management Service, (MMS) started the meeting just after 9:00 AM by introducing a panel of MMS employees which, in addition to himself, included-- Greg Smith, Bob Kronebusch, and Mike Del-Colle. The audience was comprised of members of the public, primarily representing state governments and industry. A sign-in sheet for members of the public is Attachment 1. Mr. Macy also briefly reiterated contents of the Federal Register Notice of the meeting-- that the purpose of the meeting was to assure public involvement in MMS' study of whether RIK could provide net benefits to taxpayers and what the best methods of implementing RIK might be. He summarized (1) MMS' 1995 Gulf of Mexico gas RIK pilot; (2) MMS' 1997 feasibility study; (3) the schedule of the planned 3 pilots comprising the current study; and (4) the approaches under consideration for the MMS to take its royalty in kind in the planned pilots.

Mr. Greg Smith and other panel members presented a briefing using graphics, copies of which are Attachment 2. Members of the public commented on the following topics during and after the presentation:

➢ SCHEDULE FOR THE WYOMING PILOT

PANEL: MMS plans to implement the WY pilot (beginning October 1998 and lasting 2-3 years) in 2 phases:

phase 1 would be competitive bids at lease
phase 2 would involve MMS marketer purchasing RIK production

The planned schedule on which MMS requested comments is:

leases selected	5/15/98
bids solicited	7/1/98
bids received	8/1/98
bids selected	8/15/98
begin taking	10/1/98

COMMENT: 2,3, and 5 year pilots are too long for learning.

COMMENT: It would be to MMS' advantage to open bidding at beginning of high demand period; e.g., start in April, rather than in October.

COMMENT: MMS is in a situation in which a trade off must be made between desires of marketers (who want no more than 2 weeks between bid date and takes date) and producers who want at least 2 months between RIK notice and delivery date. The schedule on which the panel requested comment seems an appropriate compromise-- (July notice by MMS of which properties' royalties we might take in-kind in October).

➢ **COMPETITIVE BID STRATEGY**

COMMENT: There is little value to the first phase of the proposed pilot (that would offer production for sale at the lease) because the lease is the least favorable point of disposition available to MMS-- therefore there is no need to test the results of sales at the lease. When selling production it has taken in kind, doesn't MMS have the right to sell its share at more favorable markets, e.g., a market center? MMS needs to get its product to a market center to be competitive.

PANEL: The net results (revenue less costs) of the competitive bid strategy will be compared to net results of contemporaneous in-value royalty payments as well as to the net results of the marketer strategy.

➢ **MARKETER STRATEGY**

PANEL: Phase 2 using a marketer requires a regulation to be in place; rule will be effective October 1999 and will cover MMS expectations re operator and marketers

The net results (revenue less costs) of the marketer strategy will be compared to net results of contemporaneous in-value royalty payments as well as to the net results of the competitive bid strategy.

➢ **PROPOSED MMS BID PACKAGES**

Comment: General agreement with MMS that information needed in bid solicitation would be:

- property identification number and location,
- average production,
- royalty determination point,
- quality information (such as gravity, and type of crude), and
- transportation information.

PANEL: Of the 9,000 bbls/day total production from Big Horn and Powder River Basins combined, MMS plans to select leases from whole range of productivity-- including minimal up to 500 bbls/day.

PROPOSED MMS BID PACKAGES, cont'd.

Comment: Suggest that MMS go out with one bid package for all of Powder River Basin and let the chips fall where they may. MMS cannot succeed at guessing at how packages will be attractive to individual bidders' unique needs and situations.

- VARIABLES IN BID PACKAGES

Panel: Comments are requested on the adequacy of the variables being used to assemble the bid packages. MMS indicated that bid packages were being assembled (8 for Powder River and 8 for Big Horn) made up of large, medium, and small producing leases/units involving 400 leases and 20-30 operators.

Comment: Bid packages should be assembled based on expectation of maximizing revenues rather than testing several ways to see what makes money.

Panel: MMS' primary goal in assembling bid packages is to make the packages attractive to purchasers.

Viscosity

Comment: Viscosity is a variable that MMS should take into consideration; some pipelines have viscosity limits that require shipper to achieve; don't necessarily make viscosity a part of the bid terms, but be aware that bidders will be considering it if it is a factor

Panel: Are there heated pipelines Wyoming?

Comment: Friction of product in the line is source of most heat, and heat from external sources is added at only a few spots on some pipelines in the State.

Transportation

Comment: MMS's proposed 10/B/D for trucked production seemed to be an appropriate threshold; below that imbalance problems arise; it really depends on how product is marketed, not what the lease produces.

Comment: With trucked leases, will MMS use operator's transportation arrangement or will bidder bring his own transportation?

Panel: Past experience suggests that bidders and operators would negotiate to use existing trucking or utilize exchanges where appropriate.

PROPOSED MMS BID PACKAGES, cont'd.

Volume

Comment: With less than 20/B/day, would marketer take the small royalty share of production periodically, perhaps 4 times a year?

Comment: No one bid package would be that small; this is a pilot and MMS could step away from any feature of the pilot that doesn't work out in actual operations.

Comment: When marketers suggested that 1500B/Day is an appropriate minimum volume that should be offered, taking that minimum and dividing that by 8 packages is not advisable if MMS is seeking to take advantage of potential economies of scale.

Comment: Marketers may not want to bid on small volume leases arguing again that bidders should be free to bid on those leases they want rather than MMS try to create packages containing a mix of attractive and less attractive leases.

Bid periods

PANEL: Bids for asphaltic sour from the Big Horn basin should perhaps be for 12 month periods during the first phase beginning October to even out seasonality of demand for that type of crude. Bid requests for Powder River production would probably be for 2 six month periods.

Comment: Bids on asphaltic crude especially should be for 1 year term (not 6 months) and should be for deliveries beginning at peak demand in April, not in October when demand for that type of crude is lower. MMS stated that the merit of various delivery start dates and length of bid terms are important factors to be tested in the pilots.

Comment: A 1-year term would still be viewed by marketers as too short; some bidders won't participate for that reason, thus skewing the usefulness of the pilot as a test.

Royalty rate

PANEL: Because lease volumes and royalty rates go together and nearly half of the Powder River leases would be stripper (1B/Day or less), the pilot would be testing how to deal with smaller volumes and odd royalty rate situations (such as sliding and step-scale leases).

Comment: A royalty rate threshold should not be needed as long as minimum volumes are met.

➢ **USE OF POSTED PRICES AS BASIS FOR BIDS/EVALUATION OF BIDS**

PANEL: The basis for bids may be a combination of posted prices; 1 or 2 or average plus premia; maybe some relation to average posted prices; or, 3 categories of posting of Conoco, EOTT, Marathon, Scurlock, and Texaco, which tend to be in line.

Comment: Why would MMS consider using postings as a basis for RIK bids when, in valuation rulemakings, MMS has insisted that postings are not acceptable indicators of value?

Comment: In selecting postings, MMS should distinguish among major purchasers who solicit but don't actually purchase and those that do purchase at actual crude postings.

Comment: Postings should not be used for basis of bids because posting are often only a starting point for negotiations; some are low, some are aggressive; using postings may lead to undesirable inferences about indexes or postings as indicators of proper value.

PANEL: MMS does not intend to base bids on postings alone; would consider any reasonable references that move with the market (such as NYMEX, spot prices, or postings) assess bids in relation to current receipts; and will always retain the right to reject any and all bids.

Comment: Is there sufficient time to assess bids properly if using historical information?

Panel: In evaluating bids for acceptance, MMS is considering looking at Form MMS-2014 data and trends from June 1997 through May 1998 and possibly to June 1998 as historical data on which to estimate what a good bid for an upcoming period should be.

COMMENT: In using historical values, you need to know which postings those historical prices were based on to estimate future acceptable bids (different postings basis leads to different values)

- **OPERATOR AGREEMENTS & RULES AFFECTING LESSEE/OPERATORS & PURCHASERS**

COMMENT: Why does MMS need to burden its operators and RIK purchasers with more agreements or rules to implement taking and marketing of MMS' production as RIK? Many lessors (such as the Canadian province of Alberta) take in kind without any agreement, and market the production.

PANEL: As a lessor, MMS must make it clear to all parties (government, lessor/operator, and purchaser) what MMS expects when production is taken in kind. Matters to be defined include, for instance, how MMS expects all parties to deal with production delivery imbalances; communication between purchasers and operators; and to interpret OCSLA and MLA requirements for competitive bid and public auction of the Government's royalty oil. The province of Alberta has rules addressing such issues to supplement its leases.

Legislation not needed to implement these approaches, only rules.

COMMENT: Agreements between working interest owners do not bind the royalty owner; the lease is the only contractual relationship between lessee/operator and lessor.

➢ **REPORTING**

PANEL: When oil is taken in-kind, operator requirement to submit a 2014 will be eliminated for oil portion of production.

PANEL: No change to report due dates; level of reporting detail will be at the lease or agreement level; only some adjustments would go to lower level of detail.

PANEL: MMS seeks comments as to whether marketer/ purchaser would prefer to report on property (lease or agreement) basis or on each LACT meter or tank? MMS prefers reporting on a meter basis but there is no need to include meter numbers in bid packages.

COMMENT: Retroactive participating area changes could be considered an inadvertent imbalance that needs to be adjusted; equity redetermination should not be a reason to not take a property's royalty in-kind.

COMMENT: How will MMS treat oil produced from well A and reinjected into well B?

PANEL: If oil remains on the same lease, MMS would treat as load oil, and no payment would be due; if oil is taken off lease and reinjected, royalty will be payable in value unless special approval is obtained from BLM to continually reinject and delay payment until oil is finally sold.

➢ **POST-AUDIT**

PANEL: Asks whether pilot should include audit of lessee values of its share; also, should MMS audit lessee's share for benchmark comparison?

COMMENT: No; industry did agree to audit of lessee values of its share in earlier Gulf pilot, but not appropriate here. Lessee's values are still reported to State Tax system.

➢ **OTHER CONCERNS**

COMMENT: Contracts may be disrupted when MMS takes in kind; we have agreements committing 500/b/d of sour crude of lessee share and royalty share from leases for year period.

PANEL: An RIK election could be considered a force majeur event under contracts; please suggest ways MMS could minimize contract disruptions when electing to take RIK.

PANEL: MMS will pursue apparent imbalances in RIK production deliveries first with the lessee/operator, then with the purchaser.

Lessee/operators would not, however be liable for purchasers' payments after transfer of title to production.

COMMENT: Would producers remain liable for entitled share? Would marketer be responsible for entitled share? Would title pass to purchaser and purchaser pay and report only what was delivered?

COMMENT: The operator/lessee may experience cash flow problems if MMS requires them to make a "monthly payment" for crude that has been produced by hasn't been picked up yet. This can happen in the case of trucked crude, which is sometimes picked up only every other month.

PANEL: Are there pipeline constraints or pro-rata situations that would hinder MMS taking in kind?

COMMENT: No situations currently preclude RIK, purchaser is shipper when government is selling at Lease. if MMS tries to aggregate will be a nightmare for MMS to bring trucked crude to aggregation points.

- **STATE OF WYOMING**

Johnnie Burton: State wants pilot to succeed. Wants to be seen as cautious observers; reserves active involvement because it believes taking at lease will lose money without marketer assistance; sees no need to test this proposition. Will review MMS's briefing in April and decide then on its participation. State wants to wait until rule permitting use of private marketer is adopted.

PANEL: Remember, we intend to reject any bids that lose money.

COMMENT: The State of Wyoming has already attempted to put leases out for bids and lost money, in part because of packaging of leases; MMS should look at why State's lease packages that got no bids were not attractive to purchasers. Does MMS have the expertise to assemble packages that bidders will see as attractive for the bidder's own purposes and situation? Packages assembled by MMS will only get average prices. Why not let marketplace workings identify those Federal leases that will get best bids?

PANEL: MMS' proposed packaging is similar to Texaco and Conoco tendering programs.

COMMENT: Establishing private tendering programs does not necessarily achieve goal of earning maximum revenues, as tendering involves additional risks and marketing costs.

PANEL: MMS also wants to find out why some producers use marketers and others do not; are the additional risks and costs of paying a marketer to sell our product at other than the lease likely to be recovered in the sales price?

The discussion ended at around Noon. The panel requested public statements any one might want to make orally or submit in writing; none were offered. The panel indicated other public meetings would be held by MMS.